

## **MANAGEMENT REPORT TO THE ACCOUNTING OFFICER ON THE AUDIT OF THE EPHRAIM MOGALE LOCAL MUNICIPALITY FOR THE YEAR ENDED 30 JUNE 2011**

### **INTRODUCTION**

1. This management report includes audit findings arising from the audit of the financial statements, reporting on predetermined objectives and compliance with laws and regulations for the year ended 30 June 2011 which were communicated to management and includes their response to these findings. The report also includes information on the internal control deficiencies that were identified. Addressing these deficiencies will assist in ensuring an improvement in the audit outcomes.
2. The management report consists of an executive summary and detailed audit findings which are contained in annexures A, B and C.

### **THE AUDITOR-GENERAL'S RESPONSIBILITIES**

3. As required by section 188 of the Constitution of the Republic of South Africa, 1996 (Act No. 108 of 1996) and section 4 of the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA), our responsibility is to express an opinion on the financial statements and to report on findings relating to our audit of the report on predetermined objectives and compliance with material matters in laws and regulations applicable to the entity. Our engagement letter sets out our responsibilities in detail. These include the following:
  - Performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements, the report on predetermined objectives and compliance with laws and regulations applicable to the entity. The procedures selected depend on our judgement, including the assessment of the risks of material misstatement of the financial statements, the report on predetermined objectives and material non-compliance with laws and regulations.
  - Considering internal controls relevant to the entity's preparation and fair presentation of the financial statements, the report on predetermined objectives and compliance with laws and regulations.
  - Evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management.
  - Evaluating the appropriateness of systems and processes that ensure the accuracy and completeness of the financial statements, the report on predetermined objectives and compliance with laws and regulations.
4. Because of the test nature and other inherent limitations of an audit, we do not guarantee the completeness and accuracy of the financial statements or the report on predetermined objectives or compliance with all applicable laws and regulations.
5. Having formed an opinion on the financial statements, we may include additional communication in the auditor's report that does not have an effect on the auditor's opinion. These may include:
  - an emphasis of matter paragraph to draw users' attention to a matter presented or disclosed in the financial statements which is of such importance that it is fundamental to their understanding of the financial statements.
  - an additional matter paragraph to draw users' attention to any matter, other than those presented or disclosed in the financial statements, that is relevant to users' understanding of the audit, the auditor's responsibilities or the auditor's report.



## THE ACCOUNTING OFFICER'S RESPONSIBILITIES

6. The accounting officer responsibilities are set out in detail in the engagement letter. These include the following:
  - The preparation and fair presentation of the financial statements in accordance with the South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP).
  - Planning, monitoring of and reporting on performance against predetermined objectives.
  - Review and monitoring of compliance with laws and regulations and disclosing known instances of non-compliance or suspected non-compliance with laws and regulations.
  - Designing, implementing and maintaining proper record keeping and internal controls necessary to enable the preparation of financial statements and the report on predetermined objectives that are free from material misstatement whether due to fraud or error, and compliance with laws and regulations.
  - Designing and implementing formal controls over IT systems to ensure the reliability of the systems and the availability, accuracy and protection of information.
  - Implementing appropriate risk management activities to ensure that regular risk assessments are conducted.
  - Disclosing all matters concerning any risk, allegation or instance of fraud.
  - Accounting for and disclosing related-party relationships and transactions.
  - Providing access to all information that is relevant to the preparation of the financial statements and performance information, such as records and documents.



## EXECUTIVE SUMMARY

### SECTION 1: Meetings with oversight bodies and those charged with governance

7. During the audit cycle we met with key stakeholders to communicate matters relating to the audit outcomes of the municipality and emerging risks. Insight was provided on the key controls that impact these audit outcomes to enable corrective action to be taken.
8. Meetings were conducted as follows:
  - Councillors induction  
18 November 2011
  - Mayor  
8 September 2011
  - Accounting officer  
15 September 2011
  - Audit steering committee  
16 August 2011  
26 August 2011  
01 September 2011  
08 September 2011  
22 September 2011  
29 September 2011  
20 October 2011  
27 October 2011  
04 November 2011  
08 November 2011  
17 November 2011
9. At these meetings commitments were made to address improvements in the internal control environment with the objective of achieving clean administration. Progress made on these commitments is discussed later in this report.



## SECTION 2: MATTERS RELATING TO THE AUDITOR'S REPORT

### PART A – MISSTATEMENTS IN THE FINANCIAL STATEMENTS

10. Material misstatements in the financial statements were identified during the audit. These misstatements were not prevented or detected by the municipality's system of internal control. These material misstatements also constitute non-compliance with the MFMA. The misstatements not corrected form the basis for the qualified opinion on the financial statements.

	Financial statement item	Finding	Impact	Internal control Deficiency
<b>Material misstatements not corrected</b>				
1.	Trade payables	Understatement of creditors balance at year end	1,693,941.82	The Chief Financial Officer did not review the annual financial statements to ensure that items are appropriately disclosed
2.	Contingent Liabilities	Contingent Liabilities not Disclosed	172,500.00	The Chief Financial Officer did not review the annual financial statements to ensure that items are appropriately disclosed
3.	Fruitless and wasteful expenditure	Fruitless and wasteful expenditure identified and not disclosed	119,994	The Chief Financial Officer did not review the annual financial statements to ensure that items are appropriately disclosed
4.	Contingent Liability	Contingent Liability not disclosed	351,600.00	The Chief Financial Officer did not review the annual financial statements to ensure that items are appropriately disclosed
5.	Expenditure	Expenditure Document not submitted for Audit	191,721.48	Proper record keeping not in place.
6.	Property plant and equipment	Asset Additions Supporting documents not provided for asset repairs and maintenance	8,530,967.37	Proper record keeping not in place.
7.	Property plant and equipment	Journal documents not submitted for asset transactions	254,786.12	The Chief Financial Officer does not ensure that journals are supported with substantiating
8.	Liabilities	Invoices not attached to journals( Existence of liability)	227,343.84	The Chief Financial Officer does not ensure that journals are supported with substantiating
9.	Property plant and equipment	Assets not physically verified(existence of assets)	921,221.21	Proper record keeping not in place.
<b>Material misstatements corrected</b>				
1.	Retirement benefit disclosure	Inconsistent disclosure of RBO	5,451,644	The Chief Financial Officer did not review the annual financial statements to ensure that items are appropriately disclosed



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		Inconsistent disclosure			
2.	Long service awards		1,538,118	The Chief Financial Officer did not review the annual financial statements to ensure that items are appropriately disclosed	
3.	Cash and cash equivalents	Bank reconciliation	812,574	The Chief Financial Officer did not review the annual financial statements to ensure that items are appropriately disclosed	
4.	Expenditure	Prior year adjustments	1,102,959	The Chief Financial Officer did not review the annual financial statements to ensure that items are appropriately disclosed	
5.	VAT	VAT Trade payable	5,000,579	The Chief Financial Officer did not review the annual financial statements to ensure that items are appropriately disclosed	
6.	VAT	VAT receivable	2,365,570	The Chief Financial Officer did not review the annual financial statements to ensure that items are appropriately disclosed	



## PART B – MATTERS TO BE BROUGHT TO THE ATTENTION OF THE USERS

### EMPHASIS OF MATTER PARAGRAPHS

An emphasis of matter paragraphs will be included in our auditor's report to highlight the following matters to the users of the financial statements:

#### Restatement of corresponding figures

11. As disclosed in note 36 to the financial statements, the corresponding figures for 2009/10 have been restated as a result of errors discovered during 2011 in the financial statements of Ephraim Mogale Local Municipality at, and for the year ended, 30 June 2010.

#### Unauthorised expenditure

12. The municipality incurred unauthorised expenditure of R25 282 264 as a result of exceeding the total amount appropriated for a vote in the approved budget.

#### Irregular expenditure

13. The municipality incurred irregular expenditure as the expenditure incurred was in contravention of Supply Chain Management Regulations and the Preferential Procurement Policy Framework relating to supply chain management.

#### Fruitless and wasteful expenditure

14. The municipality incurred fruitless and wasteful expenditure of R119 994. This was due to penalty and interest payments to SARS and the AGSA

#### Material impairments

15. The municipality had consumer debtors totalling R19 671 398 million at 30 June 2011 of which provision for impairment has been made for R14 765 638. The recoverability of these amounts is doubtful.

### ADDITIONAL MATTER PARAGRAPHS

An additional matter paragraphs will be included in our auditor's report to highlight the following matters to the users of the financial statements:

#### Material inconsistencies in other information included in the annual report

16. The annual report is not available and thus we could not identify any material inconsistencies in other information included in the annual report.

#### Unaudited supplementary schedules

17. The supplementary information set out on pages XX to XX does not form part of the financial statements and is presented as additional information. I have not audited these schedules and, accordingly, I do not express an opinion thereon.

## PART C – REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

### FINDINGS ON THE REPORT ON PREDETERMINED OBJECTIVES

Included below are the findings raised during our audit of the report on predetermined objectives.

#### Presentation of information

18. Performance against predetermined objectives is reported using the National Treasury guidelines.

#### Usefulness of information

19. The reported performance information was deficient in respect of the following criteria:

- Measurability: Indicators are not well-defined and verifiable, and targets are not specific and measurable.
- Consistency: Objectives, indicators and targets are not consistent between planning and reporting documents.
- Completeness: Indicators per the IDP not reported on in the annual performance report.

The following audit findings relate to the above criteria:

20. Indicators per the integrated development plan are not well defined and verifiable and the related targets as per the integrated development plan are not specific about deliverables and cannot be measured against objectives and indicators.

21. Objectives and indicators as per the integrated development plan are not consistent with objectives and indicators as reported in the annual performance report.

22. Indicators as per the integrated development plan are not reported on in the annual performance report.

#### Reliability of information

23. The following deficiencies were further noted:

- Accuracy, validity and completeness of reported information: The Municipality does not have an independent person who collects and verify the accuracy, validity and completeness of performance information as reported in the annual performance report.
- Progress report: The annual performance report does not have a progress report regarding progress made concerning issues identified in prior year's annual performance report.

The following audit findings relate to the above criteria:

24. The municipality does not have an independent person who collects and verifies the accuracy, validity and completeness of performance information as reported in the annual performance report.

25. The annual report does not have a progress report regarding progress made concerning issues identified in prior year's annual performance report.

26. The performance report does not contain measures to improve the performance of the municipality.

27. There is not sufficient supporting documentation for the actual results achieved in the annual performance report.

28.



## FINDINGS ON COMPLIANCE WITH LAWS AND REGULATIONS

Included below are findings on material non-compliance with laws and regulations applicable to the municipality.

### Budgets

29. The municipality incurred expenditure that was not excess of the limits of the amounts provided for in the votes in the approved budget, in contravention of section 15 of the Municipal Finance Management Act (MFMA).

### Annual financial statements, performance and annual report

30. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA. Material misstatements identified by the auditors were not adequately corrected, which resulted in the financial statements receiving a qualified audit opinion.

### Procurement and contract management

31. Goods and services with a transaction value of between R10 000 and R200 000 were procured without obtaining written price quotations from at least three different prospective providers as per the requirements of SCM regulation 17(a) and (c).
32. Invitations for competitive bidding were not always advertised for a required minimum period of days as per the requirements of SCM regulation 22(1) and 22(2).
33. Sufficient appropriate audit evidence could not be obtained that awards were made to providers whose tax matters have been declared by the South African Revenue Services to be in order as required by SCM regulation 43.
34. The preference point system was not applied in all procurement of goods and services above R30 000 as required by section 2(a) of the Preferential Procurement Policy Framework Act and SCM regulation 28(1)(a).

### Expenditure management

35. The accounting officer did not take reasonable steps to prevent, unauthorised, irregular expenditure and fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA.

### Asset management

36. The accounting officer did not take all reasonable steps to ensure that the municipality had and maintained an effective system of internal control for assets (including an asset register) as required by section 63(2)(c) of the MFMA.

## INTERNAL CONTROL

### Achievement of internal control objectives

37. Significant deficiencies that resulted in the basis for the disclaimed opinion, findings on the report on predetermined objectives and findings on compliance with laws and regulations are summarised below. Detailed information on significant internal control deficiencies is provided in section 5 of this report.

- Leadership

The municipality did not have sufficient monitoring controls in place resulting in materially incorrect financial statements submitted for audit purposes. Inadequate reviews of the annual financial statements resulted in a material adjustment to the annual financial statements.



- Financial and performance management

The financial statements and report on predetermined objectives contained numerous misstatements that were not corrected.

- Governance

The audit committee did not function as required by section 166 of the Municipal Finance Management Act, in that: The audit committee did not review the annual financial statements after year end as their term expired on 30 June 2011.

### **SECTION 3: SPECIFIC FOCUS AREAS**

#### **PART A – SIGNIFICANT FINDINGS FROM THE AUDIT OF PROCUREMENT AND CONTRACT MANAGEMENT**

The audit included an assessment of procurement processes, contract management and controls of the municipality, which should ensure a fair, equitable, transparent, competitive and cost-effective supply management (SCM) system that complies with legislation and minimises the likelihood of fraud, corruption, favouritism and unfair and irregular practices. The assessment has indicated the following deficiencies:

##### **Irregular expenditure**

38. Irregular expenditure amounting to R33 131 509 was incurred in the period as a result of the contravention of SCM legislation. One hundred percent of the irregular expenditure was identified during the audit process. The incomplete identification of SCM irregular expenditure was as a result of incorrect interpretation of the SCM policy and legislation and inadequate processes to identify irregular expenditure with regards to SCM.

##### Procurement process - Quotations

- Goods and services with a transaction value of between R10 000 and R200 000 were procured without obtaining written price quotations from at least three different prospective providers as per the requirements of SCM regulation 17(a) and (c).

##### Procurement process – Competitive bidding

- Goods and services of a transaction value above R200 000 were procured without inviting competitive bids as per the requirements of SCM regulation 19(a) and 36(1).
- Invitations for competitive bidding were not always advertised for a required minimum period of days as per the requirements of SCM regulation 22(1) and 22(2).
- Sufficient appropriate audit evidence could not be obtained that awards were made to providers whose tax matters have been declared by the South African Revenue Services to be in order as required by SCM regulation 43.
- The preference point system was not applied in all procurement of goods and services above R30 000 as required by section 2(a) of the Preferential Procurement Policy Framework Act and SCM regulation 28(1)(a).

